

**Letter of Findings: 04-20100519
Gross Retail Tax
For the Years 2007 and 2008**

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ISSUES

I. Exemption Certificates – Gross Retail Tax.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-8-8(a); IC § 6-2.5-5-18(a); [45 IAC 2.2-5-36](#).

Taxpayer argues that it was not required to collect sales tax on "medical supplies and nutritionals" purchased by various nursing homes.

II. Labels – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); [45 IAC 2.2-5-16](#); [45 IAC 2.2-5-16\(a\)](#).

Taxpayer maintains that the sale of "AM-PM" labels is exempt from sales/use tax.

III. Capital Expenditures – Gross Retail Tax.

Authority: IC § 6-2.5-5-3; IC § 6-2.5-5-1.

Taxpayer states that it was not required to pay sales tax when it purchased equipment used in a clean room.

IV. Ten-Percent Negligence Penalty.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(4); IC § 6-8.1-10-2.1(d); [45 IAC 15-11-2\(b\)](#); [45 IAC 15-11-2\(c\)](#).

Taxpayer asks that the Department abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is in the business of providing prescription medicine and supplies to "long term care facilities" (nursing homes) and to the patients in those facilities. Taxpayer also sells supplies directly to the care facilities for use in or by the facilities themselves. The Department of Revenue conducted an audit review of Taxpayer's business records. Although Taxpayer had filed annual sales tax returns, it "consistently reported zero taxable sales and zero sales tax liability." The audit assessed Taxpayer sales/use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Exemption Certificates – Gross Retail Tax.

DISCUSSION

Based on a written prescription, Taxpayer sold prescription drugs directly to nursing home patients. The audit found these sales were not subject to sales tax. The audit did not assess tax on sales which were paid under Medicare Part A and Medicaid.

However, the audit found that the sale of certain items such as "diabetes test strips, meters, lancets, sharps containers, wound measuring guides, refrigerators, positioners, pill crushers, skin prep wipes, syringe, batteries, iv-sets, tubing, wipes, isolation gowns, and external pump" was not exempt because these items were "[s]upplies used by the nursing home in rendering health care services [and] subject to sales tax and constitute taxable sales."

Taxpayer was asked to provide exemption certificates from the nursing homes. All the exemption certificates produced were signed by the same person and contained a blanket exemption claim for "medical supplies and nutritionals for the period 2007-2009."

IC § 6-2.5-2-1(a) imposes "[a]n excise tax, known as the state gross retail tax... on transactions made in Indiana." Under IC § 6-2.5-2-1(b), the retail merchant is required to "collect the tax as agent for the state."

Under certain circumstances, the retail merchant is not required to collect sales tax. For example, under IC § 6-2.5-8-8(a), "A person... who makes a purchase in a transaction which is exempt from the state gross retail tax and use taxes, may issue an exemption certificate to the seller instead of paying the tax." Once the purchaser provides the exemption certificate, the retail merchant is under no obligation to collect sales tax on the transaction. IC § 6-2.5-8-8(a) states that, "A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase." (Emphasis added).

The exemption certificates provided by Taxpayer are ambiguous in that they claim the purchaser is entitled to the "blanket exemption" but then described the items to be purchased as "medical supplies and nutritionals." All things considered, the Department is prepared to accept the exemption certificates on their face value. The purchaser is claiming that it is entitled to make blanket purchases of "medical supplies and nutritionals" without

paying sales tax. The purchasers plainly did not claim that they were entitled to purchase such items as toner, fax machines, and paper forms because these items do not fall within any reasonable interpretation of "medical supplies and nutritional" and Taxpayer should not have sold those items without collecting sales tax.

It should be noted, and as correctly noted in the original audit report, a cursory review of certain of the "medical supplies and nutritional" sold may not be exempt pursuant to IC § 6-2.5-5-18(a) or [45 IAC 2.2-5-36](#) but that is a matter between the Department and the customers which provided the exemption certificates.

The Audit Division is requested to review the original transactions between Taxpayer and the nursing homes which presented the exemption certificates and revise the assessment based on those items which reasonably fall within the category of the "medical supplies and nutritional" claimed on those certificates.

FINDING

Subject to the results of the supplemental audit review, Taxpayer's protest is sustained.

II. Labels – Gross Retail Tax.

DISCUSSION

Taxpayer purchased "AM-PM" labels. These labels were attached to prescription cards which aided nursing home personnel. The audit found these labels were not exempt and assessed Taxpayer sales/use tax.

Taxpayer argues that certain of its packaging labels are entitled to exempt status under [45 IAC 2.2-5-15](#) and [45 IAC 2.2-5-16](#). Departmental regulation states that, "The state Gross Retail Tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling." [45 IAC 2.2-5-16\(a\)](#).

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

[45 IAC 2.2-5-16\(a\)](#), like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999).

The original audit report addressed the question of whether these labels were entitled to the exemption. The report explained that, "[T]he AM/PM labels purchased by the taxpayer were attached to the prescription cards to aid the nurses in the administration of the medicines, but were not exempted." The report stated that AM/PM labels were not part of the product sold to the patient but were "applied for the benefit of the nursing home, [which] is not the patient purchaser of the product."

The Department is unable to agree that Taxpayer has met its burden of demonstrating that the proposed assessment of tax was wrong because Taxpayer has not shown that the AM/PM labels were anything other than a convenience provided to the nursing home and has not shown that the labels were affixed to the tangible personal property actually transferred to the recipient for whom the prescription was written.

FINDING

Taxpayer's protest is respectfully denied.

III. Capital Expenditures – Gross Retail Tax.

DISCUSSION

Taxpayer states that it made purchases of certain "capital assets" which were paid for during 2007 and 2008. Taxpayer argues that these particular assets were "to be utilized in the establishment of a clean room for manufacturing certain pharmaceuticals." Taxpayer asserts that the Department erred in assessing sales/use tax because the purchases were exempt.

Taxpayer cites to IC § 6-2.5-5-3 as the basis for its claim that the items are exempt from sales/use tax. In part, the exemption statute reads as follows:

(b) Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. (Emphasis added).

Taxpayer explains that equipment purchased falls within the exemption because it was used "for the direct production manufacturing fabrication or finishing... of various drugs by the company."

In addition, Taxpayer cites to IC § 6-2.5-5-5.1 which states as follows:

(a) As used in this section, "tangible personal property" includes electrical energy, natural or artificial gas, water, steam, and steam heat.

(b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining,

repairing, mining, agriculture, horticulture, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

Taxpayer suggests that "at some time [Taxpayer] will have to look at the electrical and other utilities which are provided to the clean room because they too will be exempt under this manufacturing exemption." However any discussion of the utilities consumed within the clean room would seem premature because Taxpayer has not specifically raised that issue.

It should be pointed out that a new entity (hereinafter "Compounding Company") was formed and is separate and distinct from Taxpayer. "Compounding Company" is apparently in the business of compounding, manufacturing, and reselling pharmaceuticals.

Taxpayer presented seven invoices representing purchases of various items which, according to Taxpayer, are used to manufacture pharmaceuticals.

However, the invoices all represent purchases made by Taxpayer and it is "Compounding Company" which is in the business of manufacturing pharmaceuticals. If "Compounding Company" is in the business of manufacturing tangible personal property, then "Compounding Company" is presumably entitled to claim an exemption for equipment used for "direct use in the direct production" of "tangible personal property."

Since Taxpayer – which is the entity not in the "manufacturing" business – made these purchases, it does not have standing to raise the claim.

In addition, a review of the items listed on the invoices seems to raise the question of whether or not the purchases are directly used in the direct production of pharmaceuticals. For example, the purchase of a "Clean Environment Assembly" ("Modular Hardwall Cleanroom") appears to be something other than "manufacturing machinery, tools, and equipment." The purchase of a "Digital telephone system" would – at least on the surface – fall outside the definition of "manufacturing machinery, tools, and equipment" directly used in the direct production of pharmaceuticals. Almost without question, the lease of a 2007 Lexus automobile falls outside the definition of exempt manufacturing equipment.

FINDING

Taxpayer's protest is respectfully denied.

IV. Ten-Percent Negligence Penalty.

DISCUSSION

Taxpayer asks that the Department exercise its discretion to abate the ten-percent negligence penalty.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(4) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to... pay the full amount of tax shown on the person's return... or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation [45 IAC 15-11-2\(b\)](#) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC § 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation [45 IAC 15-11-2\(c\)](#) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment – including the negligence penalty – is presumptively valid.

During the period under review by the audit, Taxpayer reported zero taxable sales and reported zero use tax liability. However, Taxpayer made sales of items which were plainly subject to sales tax and for which no exemption certificate had been obtained. In addition, Taxpayer purchased cars from its employees which "were booked at one amount on the taxpayer's books and records and reported to the BMV at a lesser amount." While the Taxpayer may continue to disagree as to whether or not sales or use tax was or was not due on particular items, Taxpayer has not demonstrated that it acted as a "ordinary reasonable taxpayer" in its failure to collect sales tax and its failure to self-assess any use tax.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

The Audit Division is requested to review transactions with entities which provided an exemption certificate claiming that "medical supplies and nutritionals" were exempt and to adjust the assessment accordingly. In all other respects, Taxpayer's protest is denied.

